Nation's Demand for Share of Income From Realty Mortgages Is Holding Back Construction

By John L. Parish
Secretary Advisory Council of Real Estate Interests

Notable changes have been made in the tax systems of the nation and the state in the last five years, all demanding of the people larger—much larger—contributions toward the cost of government. Originally forced upon the country at large by the need of a larger revenue with which to pay our way in the great war, that larger revenue is still needed, not only to defray the cost of that war but to meet the deficiencies in the governmental revenues caused by the prohibition of the sale of liquors and by abnormal increase in the cost of government.

The state governments and the municipalities also found that their expenses were greatly increased by the war and their revenues reduced by the enactment of the constitutional amendment prohibiting the trade in intoxicants.

Incidentally, as to New York State, the common sense of the people was evinced in a very general demand for an income tax system to take the place of the long discredited and impracticable personal property tax. Wherefore we have in this state an income tax system which is entirely new, and which applies, though differently, to corporations and individuals, and which is designed to considerably more than make up the losses in the state's revenue caused by prohibition and the abolition to a great extent of personal property taxation.

Task Ahead of Governor

These taxes have evidently come to stay. Government needs are growing fast, and there is besides a class of needs which are not in the strictest sense governmental, but are needs of all the people and which it seems will not be met unless the government undertakes them. Of this class of needs are railroad rehabilitation and extension, the building and development of railroad terminals, the building of some hundreds of thousands of miles of new highways, and the development of a nation-wide hydro-electric power, heat and light system.

These great developmental operations must be undertaken if the nation is to continue in the front rank of civilization, and it involves no great foresight to declare that they will be undertaken—and probably by the government (which in this sense means the people in their collective capacity)—because there are no individuals or groups of individuals so well qualified and so competent to do them. And although the government will undertake them, the people must pay for them out of their savings.

Quite naturally, the primary purpose of the lawmakers when these national and state income tax laws were enacted was to raise a tremendous revenue—for war and reconstruction purposes. It is hardly matter for surprise, therefore, that they were a little careless in considering the proper incidence of taxation, or were at least satisfied to take broad chances as to whom or what the tax should hit or miss.

As a revenue system the income tax in its broad and general application has received general approval. For a measure so largely experimental in its first forms it has demonstrated its workability, even if in practice it has disclosed some rough and uneven features in which it operates in outright violation of fundamental economic laws. Right economic principles of taxation require that the tax shall be just and equal in application; should take from the taxpayer only a part of his income, whether from rent, interests, profits or wages, and this in equal proportion conditioned upon his ability to pay.

When a tax is found in operation to bear unequally upon any industry of interest, to "obstruct the industry of the people and discourage them from applying to" (investing in) "certain branches of business which might give maintenance and employment to great multitudes," it is operating in violation of these fundamental rules; is to the extent of such violation doing more harm than good, and should, in the interest of the welfare of the people at large, be amended and corrected.

This charge of undue oppression and inequality of operation has been brought from many points upon several features of the revenue law, and upon none more aptly and properly than against the income tax sections of that law in its effect upon the building industry and all of its collateral branches throughout the country.

Tax Works Against Realty

It is in the nature of this industry that it requires for its successful promotion and operation the use of two-thirds, in the average, of the total investment, in basic capital at low rates of interest. For generations this basic capital has been readily obtained from private investors, from the great life insurance companies, from trustees and executors of the estates of deceased persons, from mortgage companies, from building, savings and loan associations and from the great title and mortgage guarantee companies that have become the chief factors in financing the larger classes of building operations in the greater industrial centers.

Rates of interest ruled at from 4 to 5 per cent in the half century between the close of the Civil War and the beginning of the great war. Lenders were content with these low rates of income from their mortgage investments because of their safety, security and freedom from need of care and attention, and because the income was fixed under mortgage contract for definite periods of time.

But then came the income tax law, levied indiscriminately upon all incomes from whatever source, whether from high profits of business or speculation or from low profits from interest on low-rate investments.

The effect of this indiscriminate levy was almost instantaneously to shut off the supply from all sources of money for investment in low interest-rate mortgages, and thus also the supply of basic capital for use in the building industries. Individuals and corporations alike who were dependent upon the income from such mortgage investments, when they found that they had to pay taxes on such income according to a schedule ranging from 4 to 65 per cent, refused to invest further in that class of securities and began at once to withdraw as fast as possible what they had already invested.

This blow at the mortgage and building branches of the real estate field came at the close of a three-year period in which the government had commandeered for war purposes all the resources of the building industry, of money, materials and man power, and in which, therefore, there had been an almost complete suspension of construction for all but war purposes.

The building industry is still held bound by these war-time conditions to some extent, but chiefly by the imposition of the income tax on the income derived from mortgages. There has been a tremendous amount of building in the year since the great victory, although nothing like what the statistics of plans filed in the building departments would indicate. These filed plans, to a considerable extent, are indicative of building operations in future, when the basic capital can be obtained, and the materials and the man power.

Besides which the needs for construction are urgent; the people need housings and offices and workshops, and the demand for these is so great that it is breaking through all artificial restraints in many directions. For the class of construction costing under $50,000 per unit there seems to be a sufficient supply of basic capital at rates of interest which builders are able to pay, but for apartment houses and business structures of the kinds that are most in demand in all the big cities and which cost from $60,000 to $1,000,000 and over to produce, the only money available is that for which exorbitant rates must be paid.

A certain amount of construction of this sort is justifiable under present conditions, provided the mortgages by which the basic capital is secured are amortized at a rate which will reduce them to normal proportions before an equilibrium between supply and demand for such housings is reëstablished, when the rents obtainable now may and probably will recede to some extent. That rents will ever again recede to levels of before the war is hardly conceivable, although ever is a long time.

Fear Rent Recession

It is the apprehension in the minds of builders that rents and costs of construction may recede to some extent within the next few years, that is holding them back from building, even if they were assured of basic capital materials and man-power. A decline of as little as 5 per cent in cost of production would probably wipe out all prospect of sale at a profit, and of 10 per cent would saddle them with actual loss. Under such conditions conservatism is their rational attitude.

A first and imperative step toward settled conditions in this all-essential industry is the release of the mortgage market from the thralldom of the income tax. People cannot be forced to lend their money on mortgages at normal rates with that income tax hanging over them. And to compel the builders to pay rates of interest for basic capital equal to the ordinary return on mobile capital means only a saddling upon the people at large of a permanent, unescapable increase in rents and in the cost of living. For the consequence of adding a permanent charge upon production is invariably an increase of cost to the consumer.

Even that might be justifiable in some cases, but this is not one of those cases. On the contrary, the lifting of this charge from the building industry will beyond question encourage investment in the industry and thus "give maintenance and employment to great multitudes." It might be added that it would stimulate as nothing else would the production of the better forms of a nation's wealth and of a municipality's taxables. Thus the nation's gain from the remission of at least a small part of the income tax from the interest on mortgages would be greatly in excess of the taxes it would lose by such remission.

It is because of this fault in the income tax law that all the interests allied with the real estate market and particularly with the financing of big building operations are collectively and severally demanding the enactment of the McLaughlin bill in Congress.

This bill does not call for the exemption from income taxation of all the income from mortgages, as in pure economics it might legitimately do, but for the exemption of the income from only $40,000 of mortgages in any individual holding, from taxation under this law. The large institutions which are chiefly engaged in financing the real estate market are all back of this bill. Their officers and managers have expert knowledge of the operation of the present law and of the vital necessity for its amendment in the manner indicated. Among them are the New York Board of Title Underwriters (embracing all the title and mortgage guaranty companies) the Real Estate Board of New York, and all the large mortgage companies. These have the cooperation and support of the Merchants' Association, the United Real Property Owners' Association and the Advisory Council of Real Estate Interests.

The McLaughlin bill has been introduced in the Senate, at Washington, by Senator Calder, and a similar bill to amend the state law will be sent to Albany for introduction soon after the Legislature shall convene, on January 1.

By that time steps will have been taken through and by which all real property interests will have opportunity to express themselves upon the measure.

In addition to this the Advisory Council of Real Estate Interests will demand of the Legislature at Albany an act limiting the power of direct taxation of real property to 60 per cent of the total annual tax levy.

There is advantage to nobody in hampering and restricting the free operation of real property development anywhere. It is the very foundation of all wealth, and every effort to burden it unjustly and uneconomically is bound to react upon all other systems and forms of production. A brilliant prospect for nation-wide development is apparent to everybody. It will be all the more certain when these unnatural restrictions are all removed.

Nassau County Factory Sold

The Nassau Suffolk Title and Mortgage Company has sold to a client of Otterbourg, Steindler & Houston the factory building at Broadway and Main Street, Lynbrook, Nassau County, on plot 150x150.

Richmond Hill Cottage Sold

Albert B. Ashforth has sold for Mrs. Elsie A. Rockliff the three-story dwelling and grounds on Herald Avenue, Richmond Hill, to Howard F. Beaucher.

Madison Ave. for Men

Madison Avenue will be developed north of the Murray Hill section as a men's street; that is, it will be a street of buildings planned especially for the display and sale of men's wear. I believe it will be fashioned after some of the Old World streets, with buildings of unusual architecture; it will have a continental atmosphere that so many American men find pleasing in the cities of Europe. Fifth Avenue will continue to grow as a woman's street and its glories will increase greatly. It will be the greatest women's street in the world. Soon we shall have this division—Fifth Avenue for women and Madison Avenue for men. — *George Backer.*

Budget Provided for Title Examiners at $3,500

Mandatory Under the Torrens Registration Law; None for Richmond

The Board of Estimate and Apportionment has provided in the 1920 budget for the employment of official examiners of titles under the Torrens registration law in the four counties of New York, Bronx, Kings and Queens at $3,500 each.

In the tentative budget a similar place was included for Richmond County, but for some reason at the last moment the Richmond County place was omitted.

This action of the city administration in providing for the official examination of titles is regarded by John J. Hopper, president of the Torrens Title League, as a great step forward, as the success of the Torrens system depends very largely upon the promptness and efficiency with which the titles are handled by the public office, and the bulk of the work falls upon the official examiner, upon whose examination and report the court depends for correct information in passing upon titles for registration.

The fees paid for the services of the official examiner are paid into the City Treasury.

Realty Is Holding Own in Fierce Competition for Money

Richard M. Hurd Says Mortgage Situation Is Improving; If It Were Not for Distractions There Would Be Plenty of Real Estate Money

By Richard M. Hurd
President, Lawyers' Mortgage Company

The first year after the cessation of the great war has shown a gradual improvement in the mortgage market in New York City. Competition for money still comes fiercely from all sources for municipal bonds, favored by exemption from Federal income taxes; for the bonds of our war allies, subject to income taxes, but yielding high rates of interest; for railroad bonds, much depressed in price owing to government administration, but tempting to some because of low prices; for new industrial stocks promising high returns, at any rate while their business is active, and so on through the long list.

Against this mass of competition the first mortagage on improved New York City real estate holds its own and sells at a lower rate of interest than any investment except tax exempted municipal bonds and the United States government bonds.

War Tested Superiority of Mortgages

The market rate for guaranteed mortgages is now 5 per cent or 5½ per cent, and for unguaranteed mortgages or mortgages of somewhat poorer quality 5½ to 6 per cent. No better proof of the upstanding qualities of an investment during times of stress is needed than the experience of savings banks, insurance companies, etc., with the railroad and other bonds, which during the five years of war have shown heavy recessions of value, as compared with guaranteed mortgages on which no institution or private investor has ever lost a dollar. Such a period as we have just passed through furnishes the acid test of all investments and demonstrates to the institution or the investor the wisdom of making short-time investments, so as to take advantage of rising rates of interest by contrast with the disadvantages of investing in fifty or one hundred year bonds on a 4 per cent or 4½ per cent basis, with interest rates going later to 5½ and 6 per cent.

Exempt Bonds Taking From Realty

The principal check in the supply of mortgage money comes from the withdrawal of funds of wealthy individuals or estates which are now being invested in municipal bonds because exempt from Federal income tax. Money, however, is flowing in from other sources. Savings banks are showing enormous increases of deposits, the greater part of which, as permitted by law, is being invested in first mortgages. The small investor is being attracted into the mortgage field by the offer of guaranteed first mortgage certificates, these being shares in a first mortgage on improved income-producing real estate in New York City.

This plan of subdividing first-class mortgages has been used by the Lawyers Mortgage Company for the last fifteen years and is growing rapidly in favor. Every year hundreds of new customers are buying these certificates in amounts of $100, $500, $1,000, etc., the total sales of the Lawyers Mortgage Company for the last year being about $2,000,000, and the yield being 5 or 5¼ per cent.

As to the building loan situation, never in the history of the United States have the cities been so underbuilt. New York in particular is suffering from an acute housing shortage, due to the stoppage of building during the war and in part to the present high prices of material and labor. Wherever the quantity theory of money is accepted—and such an acceptance is nearly universal—the phenomenon of rising prices is attributed to the diminished purchasing power of the dollar. The increase in round figures of the world's currency from $10,000,000,000 to $40,000,000,000 and of the world's indebtedness or credit instruments from $40,000,000,000 to $220,000,000,000 means an inflation under which the purchasing power of the dollar drops to 50 cents.

Many builders and lenders have hesitated to erect or finance new buildings in the City of New York, anticipating a drop in the price of material and labor, but the Lawyers Mortgage Company believes that the present basis will be maintained for many years to come, that buildings can be safely and profitably erected and financed and that the high rentals now obtaining will long continue. From every standpoint it is to be hoped that there will be a large number of buildings of all kinds erected during 1920, such action being of the greatest importance to quiet social unrest by furnishing housing facilities for the poorer classes and to restrain the existing high rents of better grade houses from going too high.

On the whole it may safely be said that the mortgages on New York City property were never on a safer basis; that real estate is a good purchase on account of the high income and that the outlook for increased mortgage business in 1920 is excellent.